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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MCI TELECOMMUNICATIONS
CORPORATION AND AT&T
COMMUNICATIONS OF THE PACIFIC
NORTHWEST,

Complainants,

v.

U S WEST COMMUNICATIONS, INC.,
GTE NORTHWEST, INC., AND UNITED
TELEPHONE COMPANY OF THE
NORTHWEST,

Respondents.

DOCKET NO. UT-970658

COMMISSION STAFF'S RESPONSE
TO FEBRUARY 13, 2002, NOTICE
REQUESTING COMMENTS ON
QWEST'S COMPLIANCE FILING
AND
VERIZON'S LETTER OF
FEBRUARY 6, 2002.

INTRODUCTION

Commission Staff ("Staff"), through its counsel, submits this Response to the Commission's February 13, 2002, Notice requesting comments regarding Qwest Corporation's (Qwest's) February 6, 2002, compliance filing, and Verizon Northwest Inc. (Verizon's) February 6, 2002, letter explaining compliance with the Commission's Fifth Supplemental Order in Docket UT-970658 issued on March 23, 1999.

BACKGROUND

1 On March 23, 1999, the Commission issued its Final Order¹ Granting Petition in this case.
2 The case began with a complaint filed by AT&T and Worldcom, alleging that the respondents
3 (Qwest and Verizon) had not removed subsidies for payphones from their regulated rates. The
4 Commission's Final Order granted the complaint and directed U S WEST Communications, Inc.
5 (now Qwest) and GTE Northwest Incorporated (now Verizon), to remove inappropriate subsidies
6 from the companies' regulated operations and to reduce certain rates retroactive to April 15, 1997.
7 Qwest and Verizon appealed the Commission's order to Superior Court, and the order was stayed
8 pending review. On February 16, 2000, the King County Superior Court upheld the Commission's
9 decision. The respondents appealed that ruling to the Court of Appeals Division I, obtaining a
10 further stay of the Commission's Order. The Court of Appeals affirmed the Commission's
11 decision in an order issued July 9, 2001. Respondents requested reconsideration and the court
12 revised the opinion on September 12, 2001. On January 7, 2002, the Court of Appeals issued the
13 mandate referring the matter back to the Commission.

14 Due to the stay of the Final Order during the court review process and the imposition of
15 interest on the outstanding rate reductions (resulting in refunds), as well as the passage of so much
16 time in which the companies' tariffs have not remained static, the calculation of the appropriate
17 amount of the refund has become rather complex. Since the Court of Appeals issued its decision,
18 Staff has been in contact with both Qwest and Verizon to assist in determining a reasonable
19 method of both complying with the Final Order's rate reduction issues, and the refund issues
20 brought about by the length of the review process. Staff comments on both the rate reduction
21 issues and the refund issues, for both Qwest and Verizon, respectively, below:

22
23 **A. STAFF COMMENTS RELATING TO QWEST'S COMPLIANCE**

24 **1. Qwest's Rate Reduction**

25 On February 6, 2002, Qwest made a filing to comply with the order (with a March 8, 2002,
26

¹ Fifth Supplemental Order in Docket UT-970658 dated March 23, 1999 (herein as "Final Order").

1 effective date). Staff is satisfied that on a going forward basis Qwest's tariff filing (Advice No.
2 3285T) complies with the Final Order.

3 4 **2. Qwest's Refund Calculation**

5 Assuming the Commission allows Qwest's tariff filing to become effective on its stated
6 effective date of March 8, 2002, on a going forward basis, Qwest needs to provide refunds to the
7 carriers who purchased Qwest's switched access service during the time period April 15, 1997,
8 when the reductions should have been effective pursuant to the federal law, to March 8, 2002. The
9 refund will be calculated by assuming the rate reduction was retroactive to April 15, 1997, and
10 calculating the interest accrued on those amounts, in accord with the court orders granting a stay
11 of the Commission's order in this case. Staff expects the amount to be refunded to Qwest's
12 switched access customers to be approximately \$5.3 Million.

13 14 **B. STAFF COMMENTS RELATING TO VERIZON'S COMPLIANCE WITH THE 15 COMMISSION'S ORDER**

16 On February 6, 2002, Verizon sent a letter explaining its compliance perspective regarding
17 both the rate reduction and refund issues.

18 **1. Verizon's Rate Reduction**

19 As noted in its letter, Verizon has made several rate reductions to its terminating switched
20 access charges over the past three years. Although Verizon did in fact reduce its terminating
21 intrastate Carrier Common Line (CCL) rate element to zero on December 21, 1998, it actually
22 shifted the revenues formerly collected through that charge to its newly created "Interim
23 Terminating Access Charge" (or "ITAC") rate element, which effectively resulted in no actual
24 decrease at all. Those changes to Verizon's rates were clearly made to comply with the
25 Commission's access charge reform rule, which was effective on December 20, 1998. Due to the
26 timing of the initial order issued on September 11, 1998, and the Final Order dated March 23,
1999, Staff believes the Commission was unaware of the changes Verizon made to its tariff rate

1 element nomenclature. To further cause confusion, Verizon later, on April 1, 1999, shifted some
2 of the ITAC over to originating intrastate CCL rate elements (albeit, still on a revenue neutral
3 basis, so no actual reduction resulted in this case either). Staff notes that it has reviewed the
4 comments of Worldcom and AT&T, filed today in response to Verizon's filing, and Staff agrees
5 that if Verizon attempts to reinstate the terminating CCL rate (the rate eliminated by its December,
6 1998 filing) pursuant to the Merger Settlement Agreement, that the reduction ordered in this case
7 should be taken out of the reinstated terminating CCL rate. If Verizon does not reinstate that rate,
8 Staff believes that Verizon's proposal, as outlined in its letter of February 6, 2002, is a reasonable
9 way to resolve the issue of compliance with the Commission's Fifth Supplemental Order in this
10 docket.

11 It wasn't until July 1, 2001, that Verizon actually reduced its CCL rate elements without
12 any offsetting switched access increases. This reduction was made pursuant to the Merger
13 Settlement Agreement and the Commission's Order approving that agreement. The reduction
14 implemented Phase IV of the settlement agreement, and resulted in a reduction in Verizon's
15 revenues in the approximate amount of \$7 million. The Commission's Order approving the
16 merger of GTE and Verizon, (Docket No. UT-981367, Fourth Supplemental Order) states in the

17 CONCLUSIONS OF LAW:

18
19 4. The rates, charges, and revenues produced under the terms of the Settlement Agreement
20 are just, reasonable, and sufficient. RCW 80.28.020.

21 After the mandate was issued by the Court of Appeals, affirming the Commission's Fifth
22 Supplemental Order in this case, Staff discussed the compliance issue with Verizon. These
23 discussions focused both on whether rate reductions had been made, to comply with the order, and
24 how refunds should be calculated. During these discussions, Verizon agreed to use the July 1,
25 2001, target date for refund calculations, rather than maintaining its original position that it would
26 end the calculation of refunds as of December 21, 1998. This additional 2 ½ years worth of
retroactive rate reductions reflected through the refund (more fully described below) will more

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than double the refunds that Verizon's switched access customers will receive. In Staff's view,

1 this position is more reasonable than Verizon's initial position, which was to interpret the
2 Commission's Final Order strictly² without reverence to the spirit of the decision.

3 In Staff's view, the rate reduction settlement suggestion offered by Staff and agreed to by
4 Verizon through its letter both complies with the letter and spirit of the Commission's decision in
5 Docket UT-970658. Because the rate reductions have been made in Verizon's existing tariffs, it is
6 Staff's view that no further compliance filings by Verizon are required. The rate reductions that the
7 filings in the Merger docket implemented were, at least in part, in response to Staff's earnings
8 review of the Company, which review used a 1998 test year. This is discussed more fully in the
9 section below. Staff recommends the Commission accept this accommodation, rather than
10 requiring a specific tariff filing, as Staff believes all parties will benefit from avoidance of the
11 expense and inconvenience that further proceedings in this matter would require.

12 **2. Refund by Verizon to Purchasers of CCL service**

13 In addition to the reasons offered above, Staff believes that Verizon providing an additional
14 refund to purchasers of Verizon's CCL service is warranted because Verizon's rates continued to
15 subsidize its payphone operations until the rate reductions took effect on July 1, 2001, and did not
16 end on December 21, 1998. Although some customers may argue they are still subsidizing
17 Verizon's payphone operation, Staff believes that is highly unlikely. The reason for this is that the
18 Verizon Merger Settlement Agreement (accepted by this Commission in Docket UT-981367)
19 actually resulted in a net \$30 Million decrease in revenues for Verizon. Although some of the
20 decrease was due to merger-related savings, the remainder was due to an earnings review of the
21 company's results of operations. The earnings review, Docket UT-991164, was performed on a
22 1998 test period which was actually post-payphone-deregulation. At that point in time Verizon's
23 payphone operation was to either be booked below the line (including the use of the FCC's Part 64
24 nonregulated allocations) or through a separate affiliate. Assuming Verizon followed FCC rules

25 _____
26 ² The Commission's Order required Verizon to reduce its CCL terminating access rate by a specific dollar amount per year; Verizon initially maintained that because it had eliminated that rate element, it did not need to make any further rate changes to comply with the order.

1 and the test year used in the earnings review included only regulated intrastate results of
2 operations, the over-earnings which contributed to the remaining revenue decrease more than
3 likely included the elimination of the \$564,076 inappropriate subsidy that the Commission found
4 in this docket.

5 By July 1, 2001, all of the Merger docket revenue decreases were complete, and therefore
6 the subsidy removed. Although this may be a factual question rather than a legal one, Staff
7 believes the weight of the evidence in the merger case combined with the interpretation of the
8 Commission's Final Order in this case, weighs in favor of approving the Verizon/Staff agreement.
9 Therefore, Staff recommends that the Commission accept Verizon's total refund offer of
10 approximately \$3.15 Million (\$1.55 Million + \$1.60 Million), subject to checking its workpapers
11 on how the refund is allocated to its customers.

12
13 RESPECTFULLY SUBMITTED this 27th day of February, 2002.

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16 _____
17 Mary M. Tennyson
18 Sr. Assistant Attorney General
19 Counsel for Commission Staff
20 (360) 664-1220
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